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*Real Economy* is a monthly economic review, tracking the most important economic evolutions and policy developments in Moldova. Its readers are policymakers, CEOs of domestic and international companies and banks, representatives of the international institutions and foreign embassies, political parties and economic journalists.

**Acronyms and abbreviations:** y-o-y - year on year; q-o-q - quarter on quarter; m-o-m - month on month; e-o-p - end of period; Q4:07 - fourth quarter 2007; Jan:09 - January 2009; NBS - National Bureau of Statistics; NEA - National Employment Agency; NBM - National Bank of Moldova; MDL - Moldovan leu (national currency); BEM - Banca de Economii; p.p. - percentage points.

**EXPERT-GRUP** is a Moldovan independent think-tank whose mission is to create a working environment in which free and non-trivial thinking thrives in order for the institution to be a leading source of unbiased economic analysis and to effectively advocate for innovative ideas and solutions to the economic problems that Moldova encounters along its path of economic transformation, societal development and European integration.

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## ■ Evolution of the Economic Leading Indicator

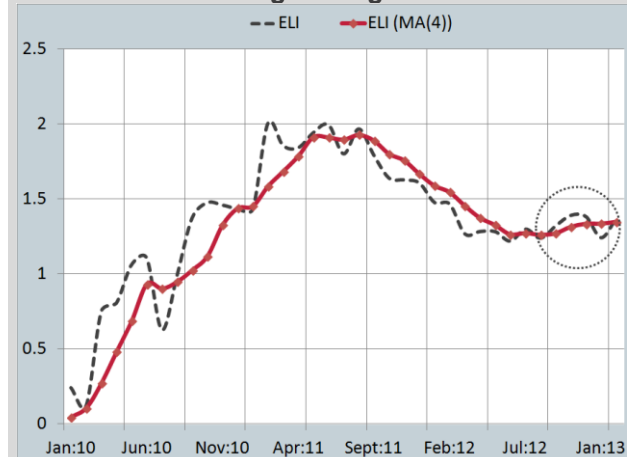
The 2013 started on a slight optimistic note, with some improvements in most components of the Economic Leading Indicator (ELI). The positive, though tepid, trend that started in the second half of 2012 continued in Jan:13 (Chart 1). It confirms the anticipated economic stabilization which will to take place this year on the ground of compensatory growth in agriculture after the severe drought of 2012. The recovery in domestic consumption will also play a role, though at lower extent.

The most important evolutions were determined by variables reflecting the external environment. Particularly, money transfers from abroad posted a 22.6% y-o-y growth, right after three months of constant downfall. This is mostly related to soaring remittances from EU, with the share of transfers in Euro currency increasing from 36.1% in Dec:12 to 38.9% in Jan:13. Hence, the ongoing economic stabilization in Europe had its impact: according to OECD Business Cycle Clock the Composite Leading Indicators and Business Confidence Index computed for Europe entered into the recovery phase in Jan:13<sup>1</sup>. A fledgling improvement of economic conditions of the most important trade partners of Moldova has fueled total exports, which soared by 9.9%, y-o-y. The positive dynamics in remittances and exports gave a fillip to domestic consumption, revealed by a resilient growth in money in circulation (+24.2%, y-o-y) and the increase in annual core inflation from 3.7% in Dec:12 to 3.9% in Jan:13.

The situation in the banking sector is more equivocal. In Jan:13, the spread (difference between average rate for credits and deposits in national currency) remained at the pre-crisis lows, whereas the total new loans slumped by 9% y-o-y. However, it didn't prevent banks from expanding their portfolios: the total stock of credits was higher by 15.7% in Jan:13 as compared to the previous year. The quality of banking portfolios slightly worsened, with the share of allowances for loan losses increasing from 10.7% in Dec:12 to 10.8% in Jan:13. However, this is totally explained by the situation at Banca de Economii. In fact, after excluding this bank, the quality of loan portfolios improved, which augurs well for further stabilization in the banking sector and the entire economy during the current year.

In conclusion, the economic leading indicator suggests the Moldovan economy entering into a nascent recovery phase in 2013. Nevertheless, the sluggish and volatile dynamics of this indicator points to a rather modest growth for the upcoming years, which is likely to remain under its potential level. The uncertainty about the domestic and foreign macroeconomic prospects continues to be very high.

**Chart 1. Economic Leading Indicator, raw data and 4-Months Moving Average**



Source: EXPERT-GRUP calculations based on NBS, NBS and Logos-Press;

<sup>1</sup> OECD Business Cycle Clock <http://stats.oecd.org/mei/bcc/default.html>

## ■ Key economic figures and data

**Agriculture.** Prospects for the agricultural output in 2013 are relatively good, as of early 2013. According to recent estimates made by Hydro-Meteorological Service of Moldova (HMSM), the reserves of productive humidity in the soil range between 100% and 130% of the multi-annual norm. Equally important, the assessment conducted by the HMSM in late January on the current conditions of the multi-year plantations show that most of the vineyards and orchards survived the winter in very good shape.

**Industry.** The year 2013 began on a somewhat downbeat mood for the Moldovan industry, which in Jan:13 declined 2.1% y-o-y. This figure was largely determined by mining sector which halved its output. However, the manufacturing sector also posted a disappointing figure of 2.9% y-o-y reduction. Production of vegetable and animal oils and fats has been the key sector behind this, generating an output 80% below previous year level. The light industry, which fully depends on the current situation on the EU markets, has entered deeper into recession. Ironically, the more 'normal' weather in Jan:13 (compared to Jan:12) led to a slight y-o-y increase in the production of thermal energy and, thus, raised the volume of energy sector output.

**Services.** In Jan-Feb:13 the total volume of transported goods increased 17.1% y-o-y, while the total length of routes – by 12%. The growth in cargo volume serves as an indirect indicator telling that Moldovan economy was on a positive track in the first quarter of the year.

**Households' income and expenditures.** Data on households income and expenditures for Q4:12, released on 28 of March, depict a slightly negative trend, with average disposable income declining 0.4% y-o-y, while the average consumption expenditures did not register any change. Remarkably, the monetary income actually registered a marginal 0.4% increase, while the main culprit came from declining in-kind income (-6.7%), which represents an obvious consequence of the severe drought hitting the income base of the rural inhabitants. Declining real wages (-8.4% y-o-y) and agricultural income (-10.5%) have made the main contribution to the marginal loss in income. On the positive balance, the income from business activity and remittances have increased significantly (+6.9% and +4.2% y-o-y, accordingly).

**Public finance.** In Jan-Feb:13 growth of state budget revenues accelerated to 19.4% y-o-y, owing primarily to fiscal collections which soared by 30%. Such a healthy growth was primarily driven by VAT collections (+30.2%), followed by direct taxes (+105.4%), excises (+14.8%) and custom duties (19.5%). Despite such positive evolutions, the total revenues underperformed as compared to the planned level, collecting 99.2% of the initially estimated amount. As in the previous month, it has been caused by the fact that only 30.5% of planned foreign grants were in fact disbursed during the first two months of 2013.

**Labor market.** On 29 of March, the National Bureau of Statistics released official data on the evolution of the labor market indicators in 2012. The data give a very worrying reading: the economically active population declined by 3.4% compared to 2011, the employment (occupation) rate reached the historical low of 38.4%. The unemployment rate reduced from 6.7% in 2011 to 5.6% in 2012. Among the economically inactive population, the number of discouraged labor increased by 6.6%, while those declared to be abroad for work purposed – by 3.6%.

**Prices.** In Feb:13 the consumer price index grew by 0.2% m-o-m. Unlike in the previous month, it has been mainly driven by non-foodstuffs, which grew by 0.4% with the most significant contribution coming from fuels (+1.4%). Foodstuffs were more expensive by 0.2% as compared to the previous month, mainly due to a 1.3% increase in the prices for vegetables, as a result of the second-round effect of the drought of 2012. The annual headline inflation declined to 4.3% (-0.3 p.p. as compared to Jan:13), owing primarily to poor domestic demand and moderate economic activity.

**Monetary policy.** The central bank did not change its main policy rate (4.5%), as the projected inflation remained within its targeted interval. Additionally, the cost-push inflationary factors, which are usually short-term and out-of-control of NBM continued to prevail: the core inflation remained below the annual CPI (3.9%, as compared to 4.3%). Hence, the monetary authority focused on its open-market liquidity sterilization operations: in Feb:12, NBM sold by 18.8% certificated more as compared to the previous year. Given the unstable macroeconomic situation and low domestic demand, the central bank is likely to maintain for some period the accommodative stance of its monetary policy. Moreover, besides maintaining the stability of prices, task fulfilled very well over the last few years, NBM is facing the challenge of maintaining the stability of the banking system amid the issues around BEM. This will be another key area where the central bank will channel its efforts during the current year and not only.

**Financial indicators.** In Feb:13 total new loans slumped by 25.8% y-o-y, owing to the contraction in national currency lending (-23.7%). As in the previous year, the banks are very reluctant in granting credits to firms, especially to SMEs: the new corporate loans decreased by 32.8% y-o-y. At the same time, the new loans granted to households visibly increased (+33.2%). Total new deposits slumped by 13.9% y-o-y, due to the short-term ones (up to 5 months), whereas the deposits with a maturity of more than 1 year grew by 53.2%, and those between 6 and 12 months – by 35.3% y-o-y. As more “long-money” came into the system, the maturity structure of banks’ liabilities continued to improve. It is the result of high economic uncertainty which makes firms postpone their investment decisions and “park” the available liquidities into banks. This is confirmed by the fact that in Feb:13 firms deposits of more than 6 months increased by 172.3% as compared to the same month of the previous year.

**Exchange rates.** In Feb:13 the average exchange rate of the national currency strengthened with respect to the US dollar by 0.4% m-o-m. It was primarily due to the fluctuations on the foreign exchange market, where the greenback lost some positions with respect to the Euro currency during the same period of time. The national currency depreciated also with respect to the Euro currency and Romanian leu by 0.5% in both cases which made the goods imported from EU slightly more expensive. The exchange rate with the Russian currency remained almost constant, the Moldovan leu strengthening by only 0.07%.

**Foreign trade.** Preliminary data on the foreign trade show that in Jan:13 exports grew 9.9% y-o-y-, while imports registered a more timid 2.8% growth. Exports to CIS countries have been more buoyant than those to EU (+17.3% y-o-y compared to +10.7%), while those to third countries receded by almost 15%. With exports to third countries covering less than 20% of the imports and with imports from third countries growing almost 12% y-o-y in Jan:13, the trade balance with these countries comes under even more severe strains.

**Key trading partners.** In Russia, the economic situation worsens rapidly: in Jan:13 the monthly GDP has grown 1.6%, while in Feb:13 – only 0.1%. According to Russia’s deputy Minister of Economy Mr. Andrej Clepach, the annual figure in 2013 will not exceed 3%. Falling profits of and investment by natural monopolies are among the key factors behind this disappointing economic dynamic. The financial turmoil in Cyprus will have an impact on Moldovan economy, even though indirectly: in 2012 Cyprus was the third in the list of countries from which foreign direct investments come to Moldova (representing, actually, Russian capital). A flight of capital invested by Cyprus funds should be expected in 2013.

**Global and regional markets.** In Mar:13, the Brent continued to gather steam, with prices reaching 116.5 USD/barrel (against 109.7 in Jan:13 and 113.0 in Feb:13). Prices for maize and wheat remain high, but on a generally receding trend (-1.1% and -8%, accordingly, compared to Jan:13). Prices for main agricultural fertilizers (phosphates, potassium) continued their declining trend in March, but prospects for mid-term are less optimistic for farmers. The falling prices for gold and silver represent a testimony of new hopes of the investors regarding the global economic prospects.

## ■ Key policy developments in March 2013

| Policy development  | EXPERT-GRUP commentary   |
|---|--|
| <p><b>March 5.</b> Moldovan Government collapsed under no confidence vote cast by 54 members of the Parliament. On March 8, the acting Prime-Minister Vlad Filat presented his resignation to Moldovan President. Earlier, on February 15, Mr. Vlad Plahotniuc (deputy-chairman of the Democratic Party) was removed from his position of first deputy-speaker of the Moldovan Parliament, with joint votes of Communists and Liberal-Democrats.</p>  | <p>The no-confidence vote adopted by the Moldovan Parliament is an intriguing political development culminating the personal showdown between Mr. Vlad Filat and Mr. Vlad Plahotniuc. Considering the current electoral mood of the Moldovan citizens and the low level of trust in all political parties composing the Alliance for European Integration, sacking the Government was a very risky political decision. However, we do expect that no early elections will be called and a new Government supported by AEI will be formed. Even more, it is highly probable that the new Government will be headed again by Mr. Vlad Filat.</p>   |
| <p><b>March 7.</b> On this date, one of the busiest Governmental meetings took place. The agenda included 52 issues. <i>Inter alia</i>, the Government approved a package of populist decisions, including the “unique” tax in agriculture, and an increase in the amount of the small pensions (those below 1300 MDL per month).</p>   | <p>The “unique” tax for agriculture is a typical example of decisions that have been adopted without properly considering the impact. The critics of the tax say it will impact negatively the owners of the small plots of land and will benefit the larger producers. The decision of increasing small pensions has been interpreted by some experts as emanation of Government fear that snap elections are inevitable in 2013.</p>   |
| <p><b>March 25.</b> Deputy chairman of the Independent Business Association of Kazakhstan, Mr. Timur Nazhanov, said in one interview to the Kazakh business portal capital.kz that outcomes of Kazakhstan joining the Russia-Belarus Customs Union are disappointing and that Kazakh businesses have suffered in result of this decision. He complained that most of the Kazakh firms in the food sector are not allowed to enter the Russian market, which is protected by non-trade barriers, while, on the other side, Russian companies are aggressively penetrating Kazakh market.</p> | <p>This statement is a testimony of the dysfunctional and unfair character of the Customs Union created by Russia, Belarus and Kazakhstan. In Moldova, there are many ardent supporters for Moldova to join this Union, and their most often used argument is that Moldova will access a vast market without any borders and barriers. In fact, joining the Customs Union will result in vast economic losses for Moldova, whose terms of trade in general with the world will worsen dramatically and which will lose its independence in setting the trade policy. As in case of Kazakhstan, Moldovan food producers will face the same barriers as they do today when trying to sell on the Russian market.</p> |
| <p><b>March 27.</b> The Parliament Standing Committee for Economy, Budget and Finance failed to vote in favor of giving the “Banca de Economii” 200 million MDL to increase the capital, as required by the National Bank of Moldova regulations.</p>   | <p>Situation of the “Banca de Economii” improved a bit compared to January-February this year. At the same time, an increase in capital is indispensable, in order for the bank to maintain its operating license. Results of the general assembly of the shareholders are not yet known. All signs are in place that “Banca de Economii” will get a solution only after the new Government is voted.</p>  |
| <p><b>March 28.</b> The leader of the Liberal Party Mr. Mihai Ghimpu declared during a Parliamentary session that his party is against ‘depoliticizing’ the General Prosecution and expressed his dissatisfaction with the results of the public selection of the candidate for the post of the General Prosecutor.</p>   | <p>The argument of the Liberal leader takes its roots in the fact that Liberal Party was seen as the junior member of the former Alliance for European Integration, without any ‘leverages’. There is a fear among the members of the Liberal Party that this situation will persist when a new coalition is eventually set up. However, a political nominee to the function of the General Prosecutor will make meaningless any attempts of justice reform in Moldova.</p>  |

## Statistical annex

Table 1. Key Monthly Indicators

| Indicator                                 | Mar:12 | Apr:12 | May:12 | Jun:12 | Jul:12 | Aug:12 | Sep:12 | Oct:12 | Nov:12 | Dec:12 | Jan:13 | Feb:13 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Industrial production, y-o-y, % ch.       | -4.0   | -2.4   | 10.6   | 0.2    | 1.0    | -5.2   | -10.7  | -6.0   | -7.9   | -3.1   | -2.1   | n.a.   |
| Retail trade, y-o-y, % ch.                | 1.5    | -3.5   | 0.5    | 0.2    | 1.6    | 1.9    | -1.2   | 4.3    | -2.6   | -12.4  | n.a.   | n.a.   |
| Services to the population, y-o-y, % ch.  | 4.6    | 9.5    | 8.6    | 2.0    | 2.6    | 3.7    | 2.5    | -1.8   | 3.5    | -1.2   | n.a.   | n.a.   |
| Exports of goods, y-o-y, % change         | 11.9   | 3.3    | 1.7    | 3.7    | -9.9   | -15.8  | 2.4    | -0.4   | -11.0  | -14.1  | 9.9    | n.a.   |
| Import of goods, y-o-y, % change          | 4.1    | 1.3    | -2.2   | -3.7   | 0.4    | -3.3   | -7.1   | 6.2    | -3.4   | -5.7   | 2.8    | n.a.   |
| Official reserve assets, million USD      | 2073.6 | 2114.0 | 2043.0 | 2059.0 | 2094.3 | 2231.6 | 2326.8 | 2421.5 | 2422.4 | 2515.0 | 2519.7 | 2488.1 |
| Freighted cargo, y-o-y, % ch.             | -27.3  | 0.3    | 24.0   | 23.9   | 23.1   | -11.5  | -16.2  | 13.9   | 1.4    | -16.4  | -13.5  | 47.3   |
| Registered unemployed at NEA (e-o-p)      | 40300  | 38477  | 34803  | 31722  | 29412  | 27243  | 25552  | 24609  | 25586  | 26297  | 26643  | n.a.   |
| Real salary, y-o-y, % ch.                 | 4.1    | 2.1    | 4.2    | 6.1    | 5.4    | 5.7    | 3.2    | 6.0    | 5.3    | 4.9    | 8.8    | n.a.   |
| Budgetary revenues, y-o-y, % ch. *        | 7.5    | 13.8   | 14.0   | 12.3   | 16.1   | 14.5   | 12.7   | 13.3   | 14.1   | 11.2   | 9.5    | 14.9   |
| CPI, y-o-y, %                             | 5.4    | 4.7    | 4.1    | 3.7    | 4.0    | 4.4    | 4.9    | 3.9    | 3.7    | 4.1    | 4.6    | 4.3    |
| IPPI, y-o-y, %                            | 6.5    | 5.8    | 5.7    | 6.0    | 5.0    | 4.8    | 5.3    | 5.0    | 4.1    | 4.5    | 1.6    | 2.8    |
| Nominal exchange rate MDL/USD (e-o-p)     | 11.81  | 11.78  | 12.00  | 12.26  | 12.54  | 12.47  | 12.39  | 12.27  | 12.37  | 12.06  | 12.10  | 12.25  |
| Money transfers from abroad, y-o-y, % ch. | -1.6   | -4.2   | 10.6   | -7.4   | 4.5    | 3.7    | -5.8   | 23.6   | 3.6    | -0.9   | 22.6   | n.a.   |
| M2 monetary aggregate, y-o-y, % ch        | 13.1   | 12.0   | 11.3   | 11.8   | 14.1   | 18.2   | 21.4   | 20.8   | 23.7   | 23.5   | 27.2   | 26.1   |
| NBM base interest rate, %                 | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    | 4.5    |
| Banks deposits interest rate, % (e-o-p)   | 7.32   | 7.23   | 7.5    | 7.59   | 7.40   | 7.15   | 7.94   | 7.72   | 7.96   | 8.44   | 8.55   | 8.56   |
| Banks credits interest rate, %            | 14.05  | 14.25  | 13.98  | 13.69  | 13.38  | 12.82  | 12.58  | 13.0   | 12.68  | 11.98  | 12.41  | 13.23  |
| Non-performing loans, % of total loans    | 13.2   | 13.6   | 14.7   | 15.3   | 15.2   | 15.3   | 14.5   | 14.4   | 14.7   | 14.5   | 14.6   | n.a.   |

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;

Table 2. Key Quarterly Indicators

| Indicator                               | Q1:11 | Q2:11 | Q3:11 | Q4:11 | Q1:12 | Q2:12 | Q3:12 | Q4:12 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|
| Real GDP growth, % y-o-y *              | 8.4   | 7.5   | 6.7   | 6.4   | 1.0   | 0.8   | -0.2  | -0.8  |
| Agricultural production, y-o-y, % ch.*  | 8.3   | 3.9   | 3.7   | 4.6   | 0.6   | -2.1  | -21.6 | -22.4 |
| Construction works f-a-p, % ch.*        | 4.0   | 12.9  | 3.1   | 1.4   | 4.9   | 3.6   | 0.8   | -1.3  |
| Fixed capital investment, y-o-y, % ch.* | 132.0 | 131.8 | 111.3 | 109.3 | 95.4  | -0.6  | -0.7  | -4.1  |
| Net FDI flows, y-o-y, % change          | 25.8  | 100   | -1.8  | 33.3  | -51.3 | -26.3 | -68.2 | n.a.  |
| Unemployment rate, %                    | 9.4   | 6.2   | 5.3   | 6.2   | 7.2   | 4.5   | 4.8   | 5.9   |
| Employment rate, %                      | 34.6  | 41.9  | 42.9  | 38.4  | 34.3  | 40.5  | 41.1  | 37.9  |

Note: \* - cumulative;

Source: NBS, NBM, calculations and estimates EXPERT-GRUP;